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In the Supreme Court of the United States

OCTOBER TERM, 1951

No. 695

THE NORTHERN TRUST COMPANY OF CHICAGO, As Executor of the Last Will and Testament of Aleta M. Gomoll, Deceased, *Petitioner*

v.

THE UNITED STATES OF AMERICA

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

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BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The opinion of the District Court (R. 37-44) is reported in 100 F. Supp. 177. The opinion of the Court of Appeals (R. 53-59) is reported in 193 F. 2d 127.

JURISDICTION

The judgment of the Court of Appeals was entered on November 5, 1951. (R. 60.) A petition

for rehearing was denied on January 12, 1952. (R. 61.) The petition for a writ of certiorari was filed on April 10, 1952. The jurisdiction of this Court is invoked under 28 U.S.C., Section 1254.

QUESTION PRESENTED

Whether, in the circumstances of this case, a dividend paid upon stock purchased under an installment payment agreement is taxable to the purchaser or to the seller.

STATUTES AND REGULATIONS INVOLVED

Revenue Act of 1936, c. 690, 49 Stat. 1648:

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service * * *, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

* * * * * * *

Uniform Sales Act, Laws of Illinois (1915), pp. 604, 610, 612:

SEC. 18. *Property in specific goods passes when parties so intend.* (1) Where there is a contract to sell specific or ascertained goods, the property in them is transferred to the buyer at such time as the parties to the contract intend it to be transferred.

(2) For the purpose of ascertaining the intention of the parties, regard shall be had to the terms of the contract, the conduct of the parties, usages of trade and the circumstances of the case.

SEC. 22. *Risk of Loss.* Unless otherwise agreed, the goods remain at the seller's risk until the property therein is transferred to the buyer, but when the property therein is transferred to the buyer the goods are at the buyer's risk whether delivery has been made or not, except that—

(a) Where delivery of the goods has been made to the buyer, or to a bailee for the buyer, in pursuance of the contract and the property in the goods has been retained by the seller merely to secure performance by the buyer of his obligations under the contract, the goods are at the buyer's risk from the time of such delivery.

* * * * * * *

Treasury Regulations 94, promulgated under the Revenue Act of 1936:

> ART. 22 (a)-1. *What included in gross income.*— * * *
>
> * * * * * * * *
>
> The fact that a dividend is declared shortly after the sale of corporate stock and the sale price is influenced by the expectation of the payment of a dividend, does not make such dividend when paid taxable to the vendor as a dividend. * * *
>
> * * * * * * * *

STATEMENT

The facts as stipulated (R. 9-20), and as found by the District Court (R. 22-25), may be summarized as follows:

In August, 1936, Edward Gomoll, hereinafter called the taxpayer (now deceased), who owned one-half of the stock of a corporation, 25 shares, agreed in writing to purchase the other 25 shares from a Mrs. Rennert for $25,000 (R. 22-23). The terms of the agreement were as follows: $7,500 to be paid in cash at the time of signing the agreement and the balance of $17,500 to be evidenced by an installment note payable over an eighteen-month period (R. 13-14); interest to be paid on the unpaid balance (R. 14); any dividends to be credited against the purchase price (R. 16); the taxpayer to have the right to vote the stock,

with certain limitations (R. 15-16); the stock certificate to be endorsed in blank and, together with installment note, to be delivered to an escrow agent (R. 14-15); legal title to the stock to vest in the purchaser only upon completion of payment of the purchase price (R. 15). The agreement was carried out. (R. 23.)

In December, 1936, the corporation declared a dividend of $300 a share and sent a check to the escrow agent for $7,500 on the 25 shares which were the subject of the above-mentioned contract and sale; the escrow agent in turn paid the proceeds to Mrs. Rennert in accordance with the agreement. (R. 11, 23.)

The taxpayer and his wife, Aleta M. Gomoll, filed a joint return for the year 1936 (R. 4); they did not include the amount of the above-mentioned dividend in their gross income, as the result of which the Commissioner determined a deficiency on the ground that it should have been included (R. 11-12). The taxpayer died and the Government reasserted the claimed deficiency against his estate and his wife; the latter and Robert A. Pickard, his executor, paid the amount of the deficiency. (R. 4.) A claim for refund was filed by the executor and Aleta M. Gomoll, individually and as legatee of the taxpayer. (R. 6-7.) The claim having been disallowed and both the taxpayer's executor and his wife having died in the meantime (R. 4), the executor of the will of Aleta M. Gomoll

brought suit for refund in the District Court for the Northern District of Illinois (R. 3-5).

The case was tried upon stipulated facts, before Judge Sullivan who, sitting without a jury, rendered judgment for the executor of the will of the taxpayer's widow. (R. 22-26.) From that judgment the Government took an appeal to the Court of Appeals (R. 27), which reversed the judgment of the District Court (R. 60).

ARGUMENT

1. The court below correctly held that the taxpayer was the beneficial owner of the stock and that the dividend paid thereon was properly includible in his income.

In accordance with the agreement of sale (R. 16) the dividend was paid over to the seller only because, under the agreement, the taxpayer had consented that dividends be used *pro tanto* to pay the purchase price of the stock. Although the taxpayer was not the record owner of the stock at the time the dividend was declared, the stock had been endorsed in blank by the seller and placed in escrow pending the completion of the payment of the purchase price. (R. 11, 17.) The taxpayer had agreed to pay a stipulated price for the stock, part of which he had already paid in cash. The remainder of the purchase price was covered by an installment note payable over a period of eighteen months. (R. 13-14, 19-20.) Not only were all dividends on

the stock to be applied against any balance due from the taxpayer under the agreement, but the taxpayer had acquired the right to vote the stock subject to certain limitations on extraordinary matters. (R. 15-16.)[1]

Further, as the Court of Appeals held, under local law (Section 22 (a) of the Uniform Sales Act, Laws of Illinois (1915), *supra*, p. 3)[2] taxpayer would enjoy any increase in the value of the stock, and would bear the misfortune if its value should become less. In the circumstances, it is clear that the taxpayer was the beneficial owner of the stock, and that the title of record was retained by the vendor merely as security for payment of the purchase price.

The decision of the Court of Appeals holding that the taxpayer, as beneficial owner of the stock involved, was taxable with the dividends paid thereon, is in accord with *DeGuire* v. *Higgins*, 159 F. 2d 921 (C.A. 2), certiorari denied, 331 U. S. 858; *Long* v. *United States*, 66 C. Cls. 475; *Lee* v. *Commissioner*, 143 F. 2d 4 (C.A. 7). See also *Moore* v. *Commissioner*, 124 F. 2d 991 (C.A. 7); *Levy* v. *United States*, 67 F. Supp. 958 (C. Cls.); and Article 22(a)-1 of the Treasury Regulations 94, *supra*, p. 4.

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[1] Prior to the purchase here taxpayer owned 50% of the corporation's stock. Hence, after the purchase agreement he had sole control over its declaration of dividends.

[2] See also 2 Williston on Sales (Revised ed., 1948), Sections 304 and 334.

2. Petitioner's contention that the taxpayer did not realize taxable income upon the crediting of the dividend against his obligation, on the theory that he was no better off in an economic sense after the payment of the dividend than before, is without merit. In the first place, the taxpayer's interest in the corporate assets aside, he was plainly advantaged when the dividend served as a credit on his fixed obligation to the seller. And this Court long ago held that a comparison between the stockholder's economic situation before and after the dividend, taking into account the reduction of corporate assets worked by the dividend, is not a proper test for determining whether a taxpayer has realized taxable income through the receipt of a dividend. *Lynch* v. *Hornby,* 247 U. S. 339, 343-346. See also *United States* v. *Phellis,* 257 U. S. 156, 171.

In the *Hornby* case, this Court recognized that the payment of a dividend diminishes, *pro tanto,* the assets of the corporation and in a theoretical sense reduces the value of the stock, but held that a dividend is taxable to the recipient despite such theoretical considerations. Thus, petitioner's notion that a dividend is not taxable when credited to the recipient's account on the ground that his economic position is not changed, has, in substance, been rejected by this Court. It is plain that if petitioner's view should be adopted as a standard for determining the taxability of dividends, no dividend would ever be taxable to

the recipient. Also, under petitioner's view, if the entire purchase price of the stock is paid from dividends declared thereon, the purchaser acquires the stock for nothing, and the seller receives nothing for it except the dividends. This would completely ignore the sale contract and also the realities of the situation.

We submit that the situation in the instant case is no different from that where stock is purchased on margin through a broker and a dividend is paid while a debit balance remains, and the broker credits the dividend against the debit balance. In such a case the purchaser of the stock receives a dividend which is includible in his gross income, since it is obvious that the purchase price of the stock has not been reduced by the amount of the dividend, and no forgiveness of indebtedness is involved.

None of the cases cited by petitioner as being in conflict with the decision of the court below are applicable. In each of those cases there had been a revision of the sales agreement effecting a partial forgiveness of the original indebtedness. Here, in accordance with the terms of the original agreement, the dividend was applied to the original purchase price.

CONCLUSION

The decision of the court below is clearly correct and there is no conflict of decisions or other reason for further review. The petition for a writ of certiorari should, therefore, be denied.

Respectfully submitted,

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